Report to the Technical Advisory Group to the Speaker's Advisory Committee on Tax Reform

A Draft Work in Progress

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October 8, 2002

There appears to be a consensus among members of the Technical Advisory Group to the Speaker's Advisory Committee on Tax Reform on several issues regarding State and local revenues, taxes, and tax reform. The issues on which there is some degree of agreement includes the following:

A. The goals and objectives of tax reform must include the following:

   1. Helping grow the economy,
   2. Stabilization of revenues on both the State and local levels,
   3. Retention of or improvements in tax system progressivity,
   4. A reduced tax burden.

B. The State and local tax burden on Maine residents is high

C. The property tax burden, in particular, is very onerous for many Maine residents and businesses because this tax does not necessarily reflect actual income of citizens or business firms.

D. The property tax burden is intensified as a result of sprawl and other factors that increase the delivery cost of governmental services.

E. There are many limitations on municipal taxing power that also limit local revenue generating capacity, which has led to high property taxes. These limitations include:

   1. Restriction of municipal revenue generation to property taxation and excise taxes on personal property. Local option sales and gross receipts taxes are not authorized tax instruments for municipalities,
   2. A number of property tax exemptions that further reduce municipal taxing capacity, and
   3. A static state share of the cost of education while the total cost of education has been increasing at a significant rate.

F. State Government needs to assume a greater share of the cost of K–12 Education, which at the same time will significantly reduce the property tax burden.

G. Targeted property tax relief better addresses the property tax problem than wholesale property tax relief that rewards high-income property owners as well as all other property tax payers.

H. State tax revenues are highly volatile and adversely impact the Maine economy. The factors contributing to this problem include:

    1. A significant number of sales tax exemptions that increase the volatility of sales tax revenues,
    2. The dependence of sales tax revenues on sales of motor vehicles and construction materials for more than 25% of total sales tax revenues,
    3. Greater than expected dependence of income tax revenues on capital gains,
    4. Economic upturns and downturns that raise and reduce tax revenues that are extremely vulnerable to economic activity.

I. Maine needs to encourage Maine residents to pursue higher education or training in skills that are in demand in order to meet the needs for a skilled workforce.

J. Eliminating volatility entirely is impossible. A budget stabilization fund would help bridge our economy and our budget during recession.

A Suggested Tax Reform Package

I. Property Tax Relief

A. Phase-out the Business Equipment Tax Refund (BETR) program and the personal property tax on machinery and equipment.

B. Target tax relief to low and middle income homeowners by repealing the Homestead Exemption and combining the funding from this program [approximately $40 million] with the Circuit Breaker [currently funded at roughly $21 million] for an "expanded" Circuit Breaker Program. According to this proposal, the Circuit Breaker program would be aligned with the income tax to become a tax credit for homeowners with combined incomes up to $80,000 and with a rebate that goes to $6000. By reducing eligibility requirements and a increasing the cap on reimbursements we can provide meaningful property tax relief to both the lower-income and middle-income families of Maine.

C. General Purpose Aid to Education – Property Tax relief

- Increase the State share from 46% to 55% of the total cost of funding General Purpose Aid to Education (GPA). Not only will the increase in General Purpose Aid help education, it will also significantly alleviate the pressure on the property tax. In addition, the increased State funding of GPA will reduce the regressiveness of the tax system, and the cost will be spread over broad-based state taxes, particularly the income and sales taxes. The cost of this proposal is approximately $200 million.

  Note: Alternatively, consider fully funding essential programs and services or a higher than 55% share of this new program.

D. Consider phasing in a property tax cap for the education portion of local taxes. The tax cap could be exceeded only upon the approval of the electorate.

- The tax cap would assure property tax payers that the increased state support of GPA would truly relieve pressure on the property tax. Local governments would not have carte-blanche authority to raise the property tax for other education purposes without the express approval of the residents. In addition, a community could spend as much as it wants on local education, even exceeding a statutory limit, if the electorate approves the spending.

E. Revenue Sharing – Property Tax Relief

- Reduce the current amount of funding to Revenue Sharing I from $106 million to $50 million or $80 million. Any revenues in excess of the $50 million or $80 million would go into Revenue Sharing II to municipalities that have an effective tax rate exceeding a minimum mill rate – e.g. 13 mills or more.

- **An Alternative Revenue Sharing program** proposal is the repeal of Revenue Sharing I and appropriating all Revenue Sharing funding to Revenue Sharing II. Only those municipalities with an effective property tax rate of more than 15 mills would be eligible for Revenue Sharing II.

F. Regionalization/Consolidation of Services – Property Tax Relief & State Tax Relief

- Establish a Commission to study and recommend to the Legislature an implementation plan for the efficient delivery of local, regional, and state services, to include, but not be limited to regionalization of administration and implementation of services.

a. The Governor and the Presiding Officers of the State Legislature will appoint the Commission.
b. The Commission will consist of representatives of municipal, county, and state governments as well as representatives of the private sector and the general public.
c. The Commission will report its findings and recommendations, including any necessary implementing legislation to the First Regular Session of the 122nd Legislature.

- Accept MMA's proposal for integration and regionalization

II. General Fund – Stabilization Account.

A. In order to reduce the volatility of General Fund revenues, especially in times of economic downturns, a General Fund Stabilization Account, capitalized at 2% of total General Fund Revenues each year [roughly $102 million for the current Biennium] and capped at 12% of General Fund Revenues, could significantly reduce fiscal dislocations in the public and private sectors. Funding for the Budget Stabilization Fund would "come off the top," and General Fund programs would be appropriated 98% of total revenues. The Budget Stabilization Fund could stand by itself or could co-exist with the Rainy Day Fund.

- During revenue shortfalls, funding for General Purpose Aid to Education and other high priorities can be better protected without severely impacting other programs. For example, when state revenues fail to meet projections, revenue sharing with municipalities also declines. If both General Purpose Aid to Education and Revenue Sharing are decreased in an economic downswing, the fiscal conditions of all Maine municipalities can be severely dislocated.

III, Improve Tax Capacity of Municipalities – Property Tax Exemption Relief

A. Currently, municipalities provide services to property owners who pay no property taxes to offset the costs of municipal services. Not-for-Profit organizations and governments are primarily the owners of this non-taxable property. In some cases, the nongovernmental organizations generate significant revenues, such as hospitals, some charitable and environmental organizations, churches, and parochial schools that could provide municipalities with a minimum "cost-of-service" payment each year. Government-owned property could also be subject to a municipal services fee.

1. There are several methods by which tax-exempt properties could pay a fair share of the cost of the municipal services they receive.

    - In the first example, all owners of currently tax exempt properties that generate $35,000 or more a year would be subject to a municipal services cost component. In this case, a per-person municipal cost component, derived by dividing the amount of municipal expenditures of the previous year (excluding education spending) by the number of municipal residents, would yield a per person municipal services cost. The per-person cost would be applied to the number of employees working for the tax-exempt organization to arrive at the organization's cost of services. The organization will annually certify to the municipality the amount of revenues generated by the organization and the number of persons employed by the organization.

    - In the second example, all owners of currently tax exempt properties that generate $35,000 or more per year would be subject to a municipal services cost component. In this case, a per-lot or per-parcel municipal cost component, derived by dividing the amount of municipal expenditures of the previous year (excluding education spending) by the number of land parcels or lots, would yield a per-parcel or per-lot municipal services cost. The per-lot cost would be applied to each parcel owned by each tax-exempt organization.

    - **Alternatively**, directly relieve the pressure on service centers by creating a state rebate for non-profit, governmental and other non-taxed properties,

    - **Alternatively,** tax non-profits with a gross-receipts tax, but releive their burden through an e-tif which could dedicate the non-profits income tax to helping relieve the burden.

IV Income Tax Reform –

A. Income Tax: Taxpayer Relief

- The current steeply progressive income tax structure that applies the highest income tax rate of 8.5% to taxable income of $33,500 or more for a “married – filing jointly” household, is extremely burdensome to the lower and middle income classes.

- By creating another income tax range and rate between the current second and third income tax ranges in Maine’s income tax structure, and by lowering the rates on the lower income tax ranges, Maine’s income tax would become less burdensome on these taxpayers. If sufficient revenues are available, the highest income tax rate could also be lowered, and Maine’s reputation as a “high tax state for wealthy people” could be softened.

- Representative Bernard McGowan proposed income tax reform in a bill submitted to the 120th Legislature in which he proposed the following:

Single Filers

Current		Proposed	
Up to $4,199	2.0%	Up to $6,500	1.9%
$4,200 - $8,349	4.5%	$6,250 - $12,500	4.3%
$8,350 - $16,700	7.0%	$12,501 - $25,000	6.7%
$16,700+	8.5%	More than 25,000	8.1%

- The tax brackets for Married filing jointly would be double those of single filers, and the brackets for heads of households would be 1.5 times those of single filers

- The revenues lost from the above proposal amount to $176 million.

Another income tax proposal would make the following changes:

Single Filers

Current		Proposed	
Up to $4,199	2.0%	Up to $12,500	0%
$4,200 - $8,349	4.5%	$12,501 - $24,999	2.0%
$8,350 - $16,700	7.0%	$25,000 - $37,499	4.5%
$16,700+	8.5%	$37,500 - $75,000	6.0%
		More than $75,000	7.0%

- The tax brackets for Married filing jointly would be double those of single filers, and the brackets for heads of households would be 1.5 times those of single filers

B. Income Tax Reform – Earned Income Tax Credit

- Tax reform measures that adversely impact the lower-income classes can be addressed through changes to the "earned income tax credit" by which low-income people receive relief when they file their income tax returns. More than 85% of low-income households file tax returns each year. The earned income tax credit benefit must be increased to offset current and any newly created adverse impacts from tax reform that harms lower-income households. The Earned Income Tax Credit should be increased to 30% of the Federal credit at an annual additional cost of $30 million.

C. Income Tax Reform – Tax Relief

1. When economic upturns increase state revenues beyond projections, a "trigger" could be established at which income tax rates could be reduced for all income classes. For example, if state revenues exceed projections by 7 percent, all income tax rates would be readjusted downward by an amount that would keep income tax revenues from increasing more than the Consumer Price Index or by a specified percentage, such as 5%.

V. Sales Tax Reform

A. Reduce Revenue Volatility Through a Broader Base

One of the major contributors to General Fund revenue volatility is the Maine Sales Tax, which has one of the most limited tax bases in the nation. Automobiles and construction materials account for more than 25 percent of total sales tax revenues. Both items are highly elastic in response to the economy. By broadening the tax base, total sales tax revenues become more stable.

1. There are many alternatives available with respect to the broadening of the sales tax base. It is important to avoid placing Maine at a competitive disadvantage when an alternative to broaden the tax base is implemented. The proposal advanced here extends Sales taxes to consumer services, but not to business or professional services.

    a. This proposal extends the sales tax to food and consumer services, including amusements and recreation. Any regressive results from these changes in the Sales tax would be offset by changes in the earned-income tax credit to help lower-income households.

    b. The additional revenues derived from broadening the sales tax base would be used to increase funding for General Purpose Aid to Education, for income tax reform, and for targeted property tax relief.

VI. Issues for Further Discussion

A. There was discussion in regard to tax reform principles and objectives to establish the principle of adequacy and sustainability of revenues to meet high priority commitments of State and local governments.

   1. The obligation to fund education and Medicaid, both of which incur cost increases that often significantly exceed those of inflation, needs to be given significant consideration.

B. Another proposal that has not been considered is to include school construction and teacher retirement in the School Funding Formula. Currently most construction and all of teacher retirement are funded by the State. Under the school funding formula, the local school districts would bear some of the burden for these programs. School districts with little State aid would experience significant local cost increases, while municipalities with significant state aid would experience less local cost increases.

   1. The school construction and teacher retirement costs, according to this proposal could be phased in over time, and initially, school districts would be held harmless with respect to these two programs.